

**BRIEF IN SUPPORT OF PETITION
FOR WRIT OF CERTIORARI**

OPINIONS BELOW

The reports and orders of the Interstate Commerce Commission are reported in 239 I. C. C. 485 and 240 I. C. C. 257. (Original Report, R. 2153-2269, and Order, R. 1258-1283; Supplemental Report, R. 1284-1317, and Order, R. 1319-1347.) The opinion of the District Court is reported in 36 F. Supp. 193 (R. 1857-1899). The opinion of the Circuit Court of Appeals is reported in 124 F. (2d) 754 (R. 2297-2317, 2334-2335).

JURISDICTION

A statement of the jurisdiction has been given in the petition (p. 8) and, to avoid duplication, is not repeated.

STATEMENT OF THE CASE

A statement of the case has been given in the petition (pp. 1-8) and, to avoid duplication, is not repeated.

**SPECIFICATION OF ERRORS INTENDED
TO BE URGED**

1. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that rejection of the Terre Haute lease, if it occurs, must take effect as of the date on which the reorganization proceeding was instituted.

2. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that, in the event of rejection of the Terre Haute lease, the lessor's claim for damages must be measured as of the date on which the reorganization proceeding was instituted.

3. The Circuit Court of Appeals erred in not directing the District Court to remand the case to the Interstate Commerce Commission with instructions that, in the event of rejection of the Terre Haute lease, the operation of the leased property after the date on which the reorganization proceeding was instituted must be for the account of the lessor.

SUMMARY OF ARGUMENT

I

Under the decision of this Court in *Connecticut Ry. Co. v. Palmer*, 305 U. S. 493, construing subdivision (b) of section 77, the lessor's claim for damages, in the event of rejection of the lease, must be measured as of the date on which the reorganization proceeding was instituted. The judgment below, if construed as decreeing that a later date may be used, is in conflict with that decision.

II

Under the decision of this Court in *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, and the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer v. Palmer*, 104 F. (2d) 161, the operation of the leased line, if the lease is rejected, must be held to have been for the account of the lessor from the date on which the reorganization proceeding was instituted. The judgment below, if construed as decreeing that the operation shall be held to have been for the account of the debtor's estate for any period after that date, is in conflict with those decisions.

ARGUMENT**I**

The decision of this Court in *Connecticut Ry. Co. v. Palmer*, 305 U. S. 493, establishes that in the event of rejection the lessor's damages must be measured as of the date on which the reorganization proceeding was instituted.

The rule applicable to the determination of a lessor's damages, in the event of rejection of the lease, is prescribed by subdivision (b) of section 77, wherein it is provided (11 U. S. C. A. § 205 (b)):

"In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings."

In *Connecticut Ry. Co. v. Palmer*, 305 U. S. 493, 502, 504-505, this Court held that the foregoing provision places leases upon the same basis as executory contracts and that the damages for breach of a lease are to be determined by the rules applicable to executory contracts, saying (p. 502):

"As reorganizations had been traditionally carried on in equity and would be carried on in a bankruptcy court with equity powers, it was natural to add the clause as to equitable proceedings. Leases were placed upon the same basis as executory contracts."

This decision requires that in section 77 proceedings the lessor's claim for damages must be measured as of the date of the institution of the proceeding. *In re New York, N. H. & H. R. Co.*, 30 F. Supp. 541, 543; *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721, 735, 744.

The reorganization plan in the instant case, however, requires that rejection of the Terre Haute lease shall take effect as of a date which is as yet undetermined but which will necessarily be long subsequent to the institution of the proceeding and thereby requires that the lessor's damages shall be measured as of that later date. Accordingly, the judgment of the Circuit Court of Appeals, if construed as approving that provision of the plan, conflicts with the decision of this Court in *Connecticut Ry. Co. v. Palmer*, 305 U. S. 493.

II

The decisions of this Court in *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, and of the Second Circuit Court of Appeals in *Palmer v. Palmer*, 104 F. (2d) 161, establish that in the event of rejection of a railroad lease, operation of the leased line after the date on which the proceeding is instituted is for the account of the lessor.

In equity reorganizations it is settled that a receiver of a lessee of a line of railroad is in no way bound by the lease, even though he operates the leased property, unless the lease is adopted. In that event the adoption takes effect as of the beginning of the proceeding, and both the receiver and the lessor are bound by the terms of the lease. Similarly, if the lease is rejected, the rejection takes effect as of the beginning of the receivership and neither the receiver nor the lessor can claim any rights against the other by reason of the lease. In the case of rejection,

therefore, the receiver's operation of the leased line is held to be for the account of the lessor from the beginning of the receivership, and the lessor is liable for all losses and entitled to receive all net earnings.

Pennsylvania Steel Co. v. New York City Ry. Co.,
198 Fed. 721, 729-731;

*Westinghouse Electric & Mfg. Co. v. Brooklyn
Rapid T. Co.*, 6 F. (2d) 547, 549-550;

*American Brake Shoe & Foundry Co. v. New York
Rys. Co.*, 282 Fed. 523, 529;

*Mercantile Trust Co. v. Farmers' Loan & Trust
Co.*, 81 Fed. 254, 258 (cert. den. 168 U. S. 710).

The applicability of this principle to section 77 proceedings is impliedly recognized by subdivision (c) (6) of the statute and is established by the decision of this Court in *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, and by the decision of the Second Circuit Court of Appeals in *Palmer v. Palmer*, 104 F. (2d) 161.¹

Section 77 (c) (6) reads as follows (11 U. S. C. A. § 205 (c) (6)):

"If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of

¹ The applicability of the principle is also recognized, by way of dictum, in a decision of the Circuit Court of Appeals for the Seventh Circuit. *In re Chicago, R. I. & P. Ry. Co.*, 110 F. (2d) 395, 399.

the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended." (*Italics ours.*)

In *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, this Court upheld as the exercise of a sound discretion action of a District Court which it recognized (312 U. S. at page 162) had been based in part upon application of the principle that rejection relates back to the date of the debtor's petition and that after that date operation is for the account of the lessor.

In *Palmer v. Palmer*, 104 F. (2d) 161, the Circuit Court of Appeals for the Second Circuit held that the rejection of a railroad lease by the lessee's trustees related back to the date on which the proceeding was instituted and that the operation of the leased line was for the account of the lessor after that date.

The reorganization plan in the instant case provides that rejection of the Terre Haute lease shall take effect as of a date which will necessarily be more than six years subsequent to the institution of the proceeding. This requires that the operation of the leased property during that period shall be for the account of the debtor's estate and not for the account of the lessor, thereby depriving the lessor of its right to an accounting of the net earnings from the beginning of the proceeding. This is contrary to the established principle that rejection relates back to the date of the petition for reorganization and that operation after that date is for the account of the lessor. Ac-

cordingly, the judgment of the Circuit Court of Appeals, if construed as approving this provision of the plan, is in conflict with the decision of this Court in *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, and with the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer v. Palmer*, 104 F. (2d) 161.

Inasmuch as our petition is directed at a possible interpretation of the judgment below which is adverse to our contention that the rule is that rejection takes effect as of the date of the institution of the proceeding, it is inappropriate here to discuss a qualification of the rule which our opponents assert exists in cases where there are present facts giving rise to special equities which might create an estoppel against application of the rule in a particular case. See *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721, 730; *Palmer v. Palmer*, 104 F. (2d) 161, 164. That question is discussed in the brief filed by these petitioners in reply to the Petition of Group of Institutional Investors and Mutual Savings Bank Group for Writs of Certiorari, in Nos. 875-883, in which we deal with the alternative construction of the judgment below, namely, that it accepts the general rule of relation back and requires the Interstate Commerce Commission to make findings of fact with respect to the existence of special equities.

Respectfully submitted,

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